RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

LETTER 943 **July 16, 1986**

July 3 DJIA 1900.81; PTI 2326; A-D Ratio -5.60
July 11 DJIA 1821.43; PTI 2322; A-D Ratio -6.41

THE PICTURE: It was quite a week -- at least it was for me. First on July 7 the Dow dropped 61.87 points, a new all-time record for pointage lost in a single day. Then that night, Faye and I practically fell out of bed as a powerful earthquake (6.0 on the Richter scale) struck Southern California. I pulled myself together, then asked Faye, "What's next, an attack by Chinese frogmen?"

What's happening here in 1986? We've already had the four biggest Dow pointage declines in history, and it's only July. To refresh your memory, on January 8 the Dow dropped 38.33 points, on April 30 the Dow dropped 41.90 points, on June 9 the Dow dropped 45.75 points -- and then we ran into the 61.87 point whopper last week. Why? How?

When you get super-speculation, when you get a 600-point rise in the Dow in a year and a half, when you get computerized arbitrage programs, when you see a new mutual fund a day, when you get option and futures speculation, when you see dozens of semi-professional wise guys telling amateur traders how they can beat the market, when you get all that-- you also get what I call "Wall Street's revenge."

What is that revenge? It comes in the form of periodic wipe-outs and gut-churning plunges. Maybe you remember something that I've written a great many times -- the bull in the bull market hates company, and he most definitely hates to be bested by neophyte traders. So periodically the bull gores the hot shots with his needle-sharp horns. Those stabbings can result in violent drops in the major averages, drops so big that they make headlines in newspapers across the nation.

All right, so much for the explanations. What do we look for next? On July 7 the DJ Transportation Average broke its previous low -- well below the May 19 low (see page 1 chart) of 771.10. But this lower Transport low was again unconfirmed by the D-J Industrials. In the last Letter I stated that I didn't care where the Transports went -- 600, 500, you name it -- as long as the Industrial Average DIDN'T CONFIRM. And so far, downside NON-confirmation by the Dow is the best and happiest part of the stock market story.

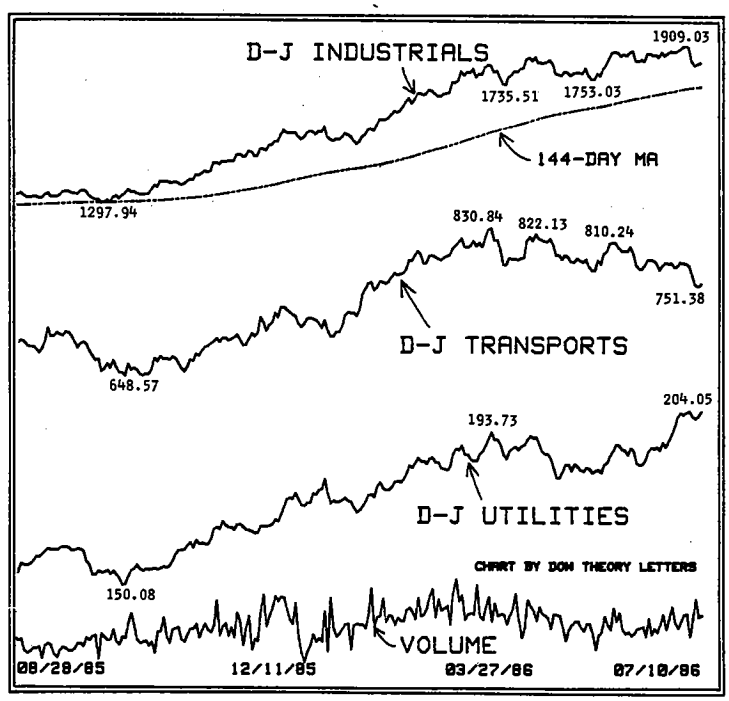
The **points to watch** on the downside (on the part of the DJ Industrials) are the 1753.03 low recorded on May 27 (see page 1 chart) and the more important 1735.51 low of April 7. If first one, then the other of these points are violated by the Dow, the market will be going into a FULL secondary reaction. In that case, I would guess that the Dow will test (make contact with) either my 144-day exponential moving average of the Dow, which now stands at (1720) or its lower 200-day moving average, which now stands at 1620. On the other hand, if the Dow stubbornly resists breaking below those two points, it will be a major PLUS for the bulls.

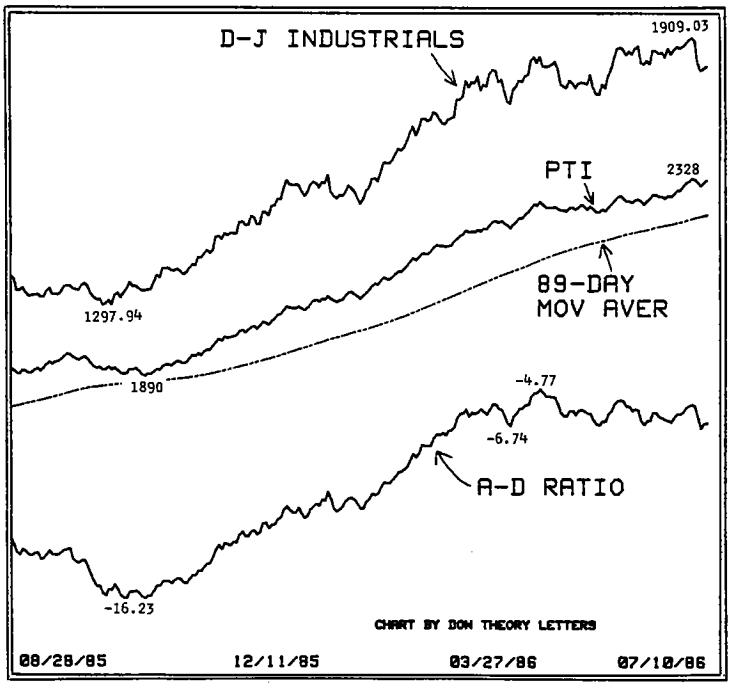
Last September the Dow came down to 1297.94 or to within a few points of its 200-day moving average. That was par for the course, and periodically we can expect this kind of healthy corrective action. And this is the reason that I wrote in recent Letters that I was bothered by the fact that (1) it has been 10 months since the Dow was anywhere near its 200-day moving averge, and (2) at its recent record high, the Dow was a whopping 300 points (18%) ABOVE its 200-day moving average. Thus I felt that the Dow and the entire market were under STRAIN. And in Wall Street upside strain is eventually relieved by downside action -- either persistent or violent.

IN A BROAD TRADING RANGE: People keep expecting all sorts of exciting things to happen in the economy and on Wall Street. These people make up what I term the "vast army of amateur 'expectors.' " One segment of this group keeps expecting inflation to roar back. But last week the CRB Commodity Futures Index slid below 200 for the first time in eight years! Furthermore, the gold-silver (stock) index (XAU) broke to its lowest level in years. And corn, the biggest agricultural crop in the US, broke below $2 a bushel to a 15-year low. So if inflation is about to come roaring back, we sure don't see it in the commodity markets (and if history means anything, those markets should be the FIRST to spot renewed inflation).

There's another group that expects the economy to totally cave in, anticipating a business mess which (they believe) will be comparable to the worst of the 1930s. But I don't think that's going to happen either -- at least not yet. If it was going to happen I would expect to see all the indications of a major primary bear market, but in my opinion they are not there yet. They will come in due time, but I don't think that time is now.

Then there is still another group which I term the super-optimists. They are looking for a boom that will take the Dow to 2,500 in a matter of months, along with an accompanying big upturn in the economy. We're in a primary bull market so I won't totally write off this scenario, but let's say that I've been skeptical. As subscribers know, I've been feeling for some time that this market has been "too easy" for us bulls. Everything's gone too smoothly, too predictably, too much our way. If you've been riding this bull market with a full house of stocks, you haven't had a real sweat or a bad time in years (until maybe last week).





Everybody in this business has been trying to pinpoint the "coming trouble." And that's only natural, because there are a lot of big egos on Wall Street. Many advisors think (mistakenly) that the only way to survive in the letter publishing industry is to have a record of great and dramatic calls. Nonsense, the way to last in this business is to keep your equilibrium, to avoid playing the reigning genius, to respect what the market is saying, and to be honest with your subscribers. Of course, it helps to have a "feel" for the market, but that's a talent or a gift that is probably bestowed from above.

As far as the current market is concerned, it's doing just about what I said it might do when, on April 4, the A-D ratio broke down and the third historic "buying stampede" came to an abrupt end. Since then, it's been a spotty market, a difficult market, a diverging market. And it's a market that is now (I believe) slipping into a BROAD TRADING RANGE of about 1900 (Dow) on the upside and 1600 on the downside. Furthermore, we are likely to STAY in that trading range for QUITE A WHILE.

The flat to declining action of the A-D ratio (page 2 chart) tells us that this market turned highly selective in recent months, but it's nevertheless been a money-maker for me and my subscribers. I have said repeatedly that the place to be was the strongest Dow stocks and this policy has worked well. I added that if the bull market was to continue, the Dow (by definition) had to rise, and that therefore the stocks to be in were the STRONGEST Dow stocks. I still feel that way, and in Letter after Letter I have listed the stongest Dow stocks.

So what can we say about the market right now and what can we do about it? My own instincts are as follows: If you have recent TRADING positions, you should probably step aside at this point. There are just too many discrepancies and divergences in this market, and discretion is the better part of valor. On the other hand, if you have well-established long-term positions, you should sit out any potential major correction. With the big profits that we now have, I believe we'd be better off simply buying more stocks at the bottom of any correction than we would be trying to time the beginning of a potential major correction.

I might add that in my experience there is NOTHING MORE DIFFICULT than attempting to time (identify) the beginning or the extent of a secondary correction within a primary bull market. "Why is that?" you ask. The answer is that bull markets love to advance with the fewest possible number of investors aboard. So how does the bull arrange to do this? He keeps everyone guessing and worrying about "the next big correction" or "the next bear market." And he invariably springs that next correction or bear market at the most disadvantageous time (and that time is when the LEAST NUMBER of people expect it or are prepared for it).

Therefore, I'm saying, let's not try to out-smart the bull. Let's not try to be Wall Steet geniuses. For long-term investsors, let's use the classic formula that has made fortunes for investors in previous great bull markets. What's the secret formula? Simply this -- buy 'em and hold 'em as long as the bull market lasts. When all is froth, foam, rumor and nonsense, sell out and stay out. And for traders, be careful here. This bull has carried the Dow up 600 points over the last year and a half, and he may be getting a bit tired or even nasty .

INVESTMENT POSITION: The bull stays in the box. This market may lapse into a wide trading range, but that doesn't mean that this isn't still a bull market. Because it is. Actually, you can make a good case for the trading range having started late last March when the A-D ratio topped out and commenced moving sideways. The strong performance of the PTI throughout that period told us that despite the topping out of the A-D, we would get a sideways rather than a severely correcting market -- and so we have. My advice to investors is still to sit tight with your stocks and your bonds.

I continue to like the muni bonds. The yield on the Bond Buyers 20 (Muni) Bond Index is currently a tax-exempt 7.82%. Note that this is better than double the taxable yield on the D-J Industrial Average. Thus, to my mind, the munis remain the biggest yield and income bargains around (and I feel that they have already adjusted for the new tax bill). For those who want to add to stock positions, I like Tri-Continental and Lehman Corp., both on the NYSE and both closed-end funds selling at roughly a 13% discount from net assets. In individual stocks, Philip Morris acts particularly well as do the oft-recommended American Home Products and JP Morgan. Another stock which I have repeatedly recommended, American Brands, has now rocketed over 100 and is a buyout candidate. The Utilities (see editorial in the July 7 Barron's) have made a major move, and good yields here are hard to find. Interstate Power, Con. Ed., Nevada Power, Tucson Electric, all mentioned here repeatedly, might still be picked up by those who need "something to buy."

ANNOUNCEMENT: Well, I guess I had to get something sooner or later. I had a heart attack back in 1971, and the doctors told me then (and they've told me since) that there was minimum damage to my heart. Things went along fine for the next 15 years except that I always had high cholesterol. I've used every low fat/salt diet under the sun, and it's obvious that my cholesterol level is a result of genetic factors. But I have recently been trying various drugs and hopefully one of them will work to get that cholesterol count down.

In the meantime, I've been having some angina and a few weeks ago, I took a treadmill test and had an angiogram. The opinion of my own internist, a top cardiologist, and an outstanding cardiac surgeon is that I'd now be better off with a bypass operation. They say I have a strong heart but that a few of my arteries are clogged -- I am (they say) a perfect candidate to benefit from bypass.

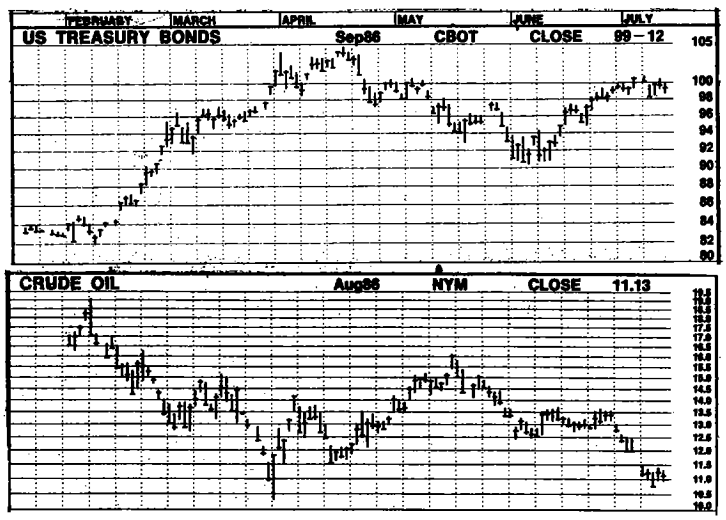
So on July 14 I go into Scripps Hospital here in La Jolla, and I'll be there for at least 8 days. Consequently, the next Letter you read (which should be on time) will be one that I have dictated to my wife, Faye. That Letter may be shorter than normal.

I know that a few of you who don't know me too well may be wondering whether I'll want to cool it from here -- or maybe even retire. I can tell you right off that I love writing these reports, I love the markets, and business here is about as good as it's been since I started in 1958. But most importantly, I wouldn't know what to do with myself if I didn't have Wall Street to ponder over and write about.

So that's the message I want to convey. With God's help I'll be in good shape, and in six months I'll be back jogging and running around the La Jolla beaches. Furthermore, I intend to write these reports until I'm over 80. But right now I'm going to need all my energy, and I therefore won't be able to answer questions or personal letters for a while. I hope all of you will understand.

CHARTS: The Treasury bond contract has formed a potential head-and-shoulders bottom. If the September contract can now push to 101, I would say that the bonds will test the highs. Otherwise (like so many other items at this time), I believe the bonds, all bonds, will have lapsed into a broad trading range.

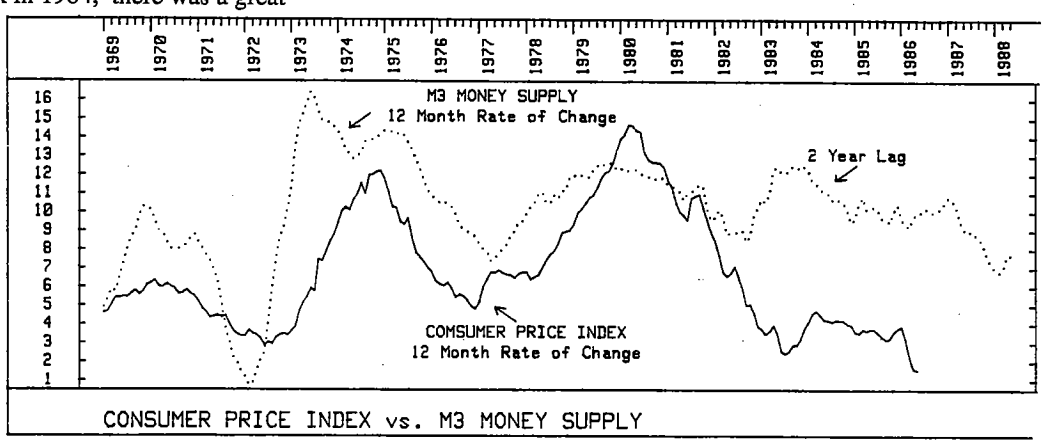
With OPEC unable to agree on very much, the crude oil (August contract) has broken down into the 10 ($10 a barrel) area again. All one can say here is (with a little prayer) let's hope that we're in a trading range on the crude, and that 10 holds! Amen.



I won't show the grain charts, they're too pathetic. Suffice it to say that farmers are talking about storing the grains in the streets, there's so much of it. Incredible with half the world hungry, but the laws of supply and demand never fed a hungry family. Not with inefficient or degenerate governments across the face of Africa and a good deal of Asia.

MONEY SUPPLY & INFLATION: With M-1 zooming into the wild blue yonder, everyone is wondering why inflation isn't heating up. And the answer is probably as follows: M-1 includes checking accounts but NOT CDs. Back in 1984, there was a great incentive to keep money in CDs. At that time CDs paid 10% to 11% and checking accounts paid roughly 5%. But today the spread in favor of CDs is down to 2% or less. So the current M-1 figures are distorted to the high side as money stays in checking accounts rather than switching to CDs.

As a result, the current M-3 figures (which include both checking accounts and CD money) is a much more accurate statistic for purposes of measuring the level of the money supply. Ned Davis of Ned Davis Research (PO Box 2089, Venice FL 33595) is well aware of the M-1 distortion, and he recently issued this chart of the consumer price index and the rate of change for the M-3 money supply. Since there tends to be as much as a 2-year LAG as far as M-3's effect on the economy, Ned has advanced the M-3 rate-of-change by two years.



Note that the M-3 index has been in a downtrend since 1983, and NOT coincidentally, the rate of inflation has been sliding during that same period. That would seem to explain why inflation has been coming down and why the M-1 figures today are less than useless.

TECHNICAL MANIA: One of the things I've learned about this business is that when anything, a stock group, a particular index (such as M-1), a trading method or a certain approach, becomes TOO POPULAR, TOO WIDELY FOLLOWED, then watch out. You're going to run into trouble if you join the popularity crowd.

When I first started in this business 28 years ago the technical method wasn't just ignored, it was hated. The banks, the institutions, Wall Street, the analysts, they positively HATED technical analysis. When I wrote my first of 17 technical (actually, Dow Theory) articles for Barron's in December 1958, the editor of Barron's felt it necessary to check with the big guns at Dow Jones to get permission to run the article. I waited almost a month before we got the final clearance.

Obviously, times have changed. Now you can listen to Financial News Network and get the latest daily opinions from leading technical gurus. The newspapers and magazines comment on divergent action in the stock averages. Brokerage houses issue technical reports on stocks and stock groups that are graded on the basis of momentum and relative strength. Various moving average studies are seen in Investor's Daily and the action of NYSE specialists and odd lotters are followed by thousands of traders today.

What does it all mean? For me, the meaning of the widespread use of technical analysis is this: I now find myself being much more careful, even cynical, about following many of the standard technical approaches -- particularly the widely-accepted ones. I once wrote that the ART of market analysis (and don't kid yourself, it isn't a science) is knowing what methods to THROW OUT at any given time! That statement was never truer than it is today.

In analyzing today's market, you will note that I consistently emphasize the theme that this is a primary bull market and that in a bull market we let the great power of the major trend work for us. Or as they say on Wall Street, "The trend is your friend." In Dow Theory Letters, we don't indulge in in-and-out trading, we don't play the option game, we don't get sidetracked into puts and calls, and we don't fool around with margins (and get knocked out of the box on the first important decline). No, we buy good dividend-paying stocks and we HOLD 'EM. We buy, we accumulate, we reinvest, we resist the bearish warnings, and we

watch for confirming signs, signs that tell us that the primary bull market remains intact.

What are some of the signs I look for? Well, first remember that I stick with the Dow Theory adage which states, "A trend remains in force until PROVED otherwise." This simple concept is probably the single most important and fundamental concept in investing. Believing in the bull market, I then look for PRICE confirmation. To me, there is nothing as important as price confirmation in a bull market (or a bear market for that matter).

Therefore, during a bull market (such as this one), I obviously watch for upside breakouts and confirmations from the D-J Industrial and Transportation Averages. But I also watch for new highs in the various broad composite averages such as the Wilshire 5000, the NYSE Composite or the S&P 500. And when we get a series of upside breakouts among the various averages and indices I consider such action bullish. In a primary bear market you just don't see across-the-board new highs in the major averages. After all, a bull market, by its very definition, pertains to PRICE. Therefore, nothing in a bull market is more bullish than broad upside price confirmation and re-confirmation. This rule, ironically, seems too simple and too fundamental for most analysts to grasp (they get lost in all kinds and varieties of technical studies, many of which have not been tested through time).

RUSSIA: Why so much about Russia in Dow Theory Letters? Answer: The major reason for today's almost catastrophically expensive US military budget is Russia. If Russia didn't exist, or if Russian intentions were peaceful, the current $300-billion US defense budget would probably (in time) be trimmed to $50 to $100 billion, with a resultant total change (for the better) in federal finances and in U.S. taxes.

On to the latest about Russia. It is becoming increasingly clear that the Russian economy is in trouble. It is also becoming obvious that massive changes will be needed in the Russian economy if that economy is to become workable. The fact is that Russia's current system is so inefficient, so incapable of real production, so demoralized, that the biggest items on the Russian business landscape are apparently vodka and loafing. And the most visible thing on the Russian homefront is the line (and I mean lines of people waiting to buy something -- anything). The fact is that the Communist system of state-directed economics is barely functioning today. Gorbachev knows it, the Russian people know it, and embarrassing for Russia -- the world knows it!

Aside from the abysmal inefficiencies of the system, the Russian economy has been sacrificed to the gods of the military. While Russia has built the world's largest standing army, while Russia has given its all to its military and to its military leaders, the civilian economy and the Russian means of production have gone down the drain. But now Russia is at the crossroads. Russia is now facing the FRIGHTENING FACT that it isn't the way that the system is working that's wrong, it's the SYSTEM ITSELF. The system just doesn't produce. The fact is that people don't work for love of country, they work for their family and for themselves and for profits. Yet because of Communist economic dogma and because of the rigid, built-in Soviet leadership structure, it is almost impossible to change the system in any fundamental way.

On top of this, its satellites are an increasing problem for Russia (how to hold them all together). And then there are the deadly costs related to Afghanistan, Cuba, the wars in Africa, Nicaragua, Ethiopia, Vietnam. In all, it's a case of an inefficient, soggy Russian economy in the face of increasing problems from the outside. And perhaps most humbling of all is that before the 1980s are over, Japan will PASS Russia as the second largest producer of world goods and services! The world is now actually SEEING that capitalism and free enterprise are far superior to the planned socialist state! And Russia is rapidly losing the world propaganda war (and horror of horrors, what happens if capitalist-leaning China starts catching up to Russia, which it is doing?).

What is all of this leading up to? To my mind, it could be leading up to a GENUINE peace effort on the part of Russia. And it could be leading up to a world pullback and a change of strategy on the part of Russia. In the real world (communist or capitalist), you can't do it if you can't finance it. My feeling is that in the next few years Russia is going to face that little fact. At that time (and maybe sooner) we may see a real peace offensive on the part of the Soviets as well as a perception by the rest of the world that capitalism is decisively triumphing over communism. You can imagine how the stock markets of the free world would take that kind of news. Interesting note: A few weeks ago President Reagan said that Gorbachev was "the first Russian leader, to my knowledge, that has ever voiced the idea of reducing, and even eliminating, nuclear weapons." That isn't completely true, but it presents a glimmer of hope for the future. Along these lines, study these headlines from the July 3 USA Today. There could be a BIG story on the horizon!

USA TODAY

WASHINGTON — President Reagan is writing a new letter to Soviet leader Mikhail Gorbachev and says their correspondence is making him "optimistic" that the two leaders will meet in the USA this year.

Reagan, in an interview with USA TODAY, said the correspondence has "opened additional doors that make me optimistic that we're not only going to have a summit, we're going to have a summit where we can reach agreement."

Gorbachev's letter was "worthwhile" and "quite a packet" of proposals on arms control, regional conflicts and human rights, he said.

"Now we have reason to believe a meeting is possible" between Secretary of State George Shultz and Foreign Minister Eduard Shevardnadze to prepare for a summit.

Q & A: Question: Russell, I'm just plain worried about this stock market. Would you tell us a bit more about identifying THE ULTIMATE top?

Answer: I wrote in the first Letter of 1986 that the most useful thought in the market is the Dow Theory concept which states, "The trend continues until proved otherwise." Of course, you can carry that thought to the point of idiocy, because ultimately you're going to have a September 2, 1929. In case you don't remember, that was the day before the final peak recorded on September 3, 1929. So what I'm saying is that nothing -- no adage, no thought, no rule, no system -- will catch the exact top of any stock market move. But the safest and most reasonable method of operation does ride on the phrase, "The trend continues until proved otherwise."

There are two ways a sane investor can operate if he or she wishes to avoid catastrophic declines in a potential bear market. The first method is this: you can sell or scale back (during the bull market) simply when you've had enough. All right, but when is enough enough? In my opinion, it's time to sell when your stocks are far above known values based on yields (or when average yields are pushing the 3% level, to use the classic measurement).

Enough is enough when your guts start churning or when you find yourself losing a lot of sleep at night. I felt that way about gold in 1980, and I sold a good deal of gold in the high 500s and in the 600s. I felt at that time that "enough was enough," and I cashed in my chips (or I should say, coins). Nobody told me when I sold my gold in the 600s that gold was going to 850 -- and then it would crash. I just found myself nervously pacing the floor at night, keeping my wife awake, and turning on the radio at 3:50am (California time) in order to catch the first London fix. The gold rise was beginning to affect my equilibrium. When that happens, it's back to cash for Richard Russell.

The second method of avoiding disaster is simply to sell when your indicators (be they Dow Theory, the PTI or any other method) say that the bull market is over.

I've sold stocks, gold and bonds by both methods. The first may get you out too early, and the second may get you out a bit late. So

as I was saying, there is no perfect method of operation in the stock market. But there are many intelligent approaches, and I try, to the best of my ability, to stay with a few of them.

Question: The DJ Transportation Average has been lagging badly (diverging) ever since last March. Is the Transportation Average really worth watching? I read the following from a June 9 Dean Witter technical report: " ... We have simply not used the DJ Transports as an indicator in either direction for many years. In our opinion, it is the poorest constructed popular index as half its components benefit from lower energy prices and others such as the 'resource rails' gain through higher energy prices. Many indexes have important flaws, but this one has so many internal contradictions that it is not worth following."

Answer: Here I go again. I have been defending the worth of the Transportation Average (formerly the Rail Average) for 28 years or ever since I started writing about Dow Theory. In the old days it was said that railroading was an obsolete industry and that the rails were therefore worthless for confirmation purposes. Then in January 1970 Dow Jones finally revised the Transportation Average, eliminating some rails and adding airlines and truck carriers. Everyone conceded that the Transports were then at least a valid indicator of transportation and cargo and personnel movement.

As far as the Dean Witter argument that some transports benefit from lower oil and some are hurt, so what? Then the oil problem cancels itself out in the Transport Average! The more important points are (1) is the thesis that the Transports must in due time confirm the movements of the Industrials a correct one? And (2) does the confirmation principal work in actuality?

I firmly believe that if the manufacturing sector of the economy (using the Dow as proxy) is to expand, then that expansion must be CONFIRMED by the transportation sector (using the Transportation Average as proxy). If you make the goods but don't ship them, you're not going to prosper. And if you ship your head off but your manufacturing sector is not doing well, then you aren't going to have a prosperous economy (and that's the rationale for the confirmation principle).

As to whether the confirmation thesis actually works, I defy you to show me a period in stock market history where the confirmation principle, applied correctly, did not work. Today, everyone is talking about the fact that the DJ Transports have not confirmed the DJ Industrials. But these people read the confirmation principle incorrectly. The fact is that the Dow has persistently refused (and remember, this is a bull market) to confirm the weaker action of the Transports. My bet is that (in due time) the Transportation Average will gather strength and confirm on the upside (this would entail the Transports rising to a new bull market high above their March 31 peak of 830.34). Remember also that in a bull market we give the bullish forces every benefit of the doubt. In today's case the skeptics are doubting that the Transports will ever confirm. I'm of the opinion that the skeptics and bears will be proved wrong.

NOTES & QUOTES: Talking to my local stamp and coin experts, I learned that stamps, after taking a terrible beating during the 1981-86 period (down as much as 70% in some cases), are now firming slightly. "How much off the bottom would you say good US stamps are?" I asked. The answer, "Maybe 10 to 12%." Coins are a different story. The high-grade (MS-65) end of the coin market has been hot. Anything lower, even MS-60s to MS-63s, has not moved up nearly as much. Today the bull market is definitely in coins rather than stamps.

* *

Talking of collectibles, the recent Reno classical auto auction (at Harrah's) saw a Bugatti Royale (one of only six ever made) go for the highest price of any car in history -- $6.5 million, to Jerry Moore of Houston (he owns 150 shopping centers). Previously the highest price paid for a car was $2.3 million for the Beatles' modified Rolls. Below that was Tom Monaghan's (of Pizza fame) payment of $1 million for a Duesenberg (which by the way, was an American-made car).

* *

Subscribers from 15 to 25 years back remember that I used to wax poetic over the great living conditions of San Diego. Then about 5 years ago I halted my praises. Why? Because suddenly, the rest of the world seemed to have discovered the hidden wonders of San Diego. Now it is unofficially announced that San Diego (with a population over 1 million) has passed Dallas and is the seventh largest city in the US. A local bumper sticker states, "Keep San Diego beautiful--when you leave, take a friend."

* *

The debate is now going on, on how the new tax bill is going to work and who is going to win or lose. Meanwhile, my own feeling is that you can keep the whole thing. It's not simplification, and it's not going to be a boon to the nation. Meanwhile the Treasury has stated that while keeping the $2,000 personal exemption, a FLAT TAX of 16% or 17% across the board for everyone would produce the SAME amount of money as the current tax law does. That would be real simplification, and that is the way I would go. But a 16% flat tax would put the tax industry out of business, and I guess that will never happen (remember, most members of Congress and the Senate are lawyers).

* *

The Supreme Court on July 7 ruled Gramm-Rudman as it was set up -- unconstitutional. But there is a fallback provision in GR which states that the heads of the CBO and the OMB would still determine a list of cuts if the deficit target is not hit. Both houses would then have to vote on the cuts within five days. And any measures agreed upon would go to the president for veto or signature.

* *

One of the major problems in the US economy is NOT addressed by either the Senate or House version of the new tax bill. This the disincentive to SAVE in the US, vs., for instance, the great incentives to save in Japan. The savings rate in the US is now 5% vs. a 20% savings rate in Japan. If personal taxes in the US are lowered, consumers will have more to spend and presumably they will spend it. Meanwhile, interest and dividend income is taxed in the US. But in Japan up to $300,000 in savings is TAX FREE -- with a disincentive to borrow (you can't write off your interest payments in Japan). Thus, with savings bulging in Japan, capital is easy to find and banks have access to mountains of CHEAP money.

* *

Politics: Many political sages believe that the gigantic July 4 celebrations represented the peak of publicity and power of Lido Anthony (Lee) Iaccoca. Although often mentioned as a presidential contender, Iaccoca has made it clear to his friends and to the politicians that he definitely does not want the job. Personally, I believe him. ... As for Mario Cuomo, my feeling is that he represents the old-line Democrats, a dinosaur of New Deal persuasion. As such, I personally don't think he has a chance, and moreover I don't think the Democrats will run him. As things stand now, if I had to bet I would bet on Gary Hart as the Democratic standard bearer. As for the Republicans, I feel that George Bush is too prissy and lacks sex appeal. My guess at this point is either Laxalt or Dole.

* *

I want to thank Robert Bleiberg, publisher and editorial director of Barron's, for his Barron's editorial on the page 9 , July 7th issue. In that issue Mr. Bleiberg goes back and reviews my utility comments from a 1983 Barron's and then updates the piece with an excerpt from my June 18 Letter, again on utilities. In case you're wondering, I still like the utilities and think that they represent some of the best values on the Big Board at this time.

* *

Presidents retire with pensions today, and I'm all for it. I think it's disgraceful to see (as once was the case) an American president bankrupt or scratching for money once he's out of office. Presidents in former days didn't have it so good (and nobody paid them $2 million to write their autobiographies). Here are a few examples. ... James Madison left office in debt. He tried to take out a $6,000 loan, failed, eventually had to sell off some of his land. His widow, the famous Dolly Madison, spent years struggling to pay off the family debt ... James Monroe, Madison's successor, owed money to two banks when he left office and had to sell his

3,500-acre Virginia plantation to pay his bills ... Andrew Jackson died with debts amounting to $26,000, equal to almost $3 million today ... Ulysses S. Grant left the White House deeply in debt, became a stockbroker in a firm that went bankrupt to the tune of $16 million. Grant's partner was a crook but Grant was exonerated. Dying of cancer, Grant made a deal with Mark Twain for the latter to publish his autobiography. Grant finished the book, but died almost penniless before the book was ever published. Twain later published the biography, made $350,000 on the sale of the book -- and gave all the money to Grant's estate.

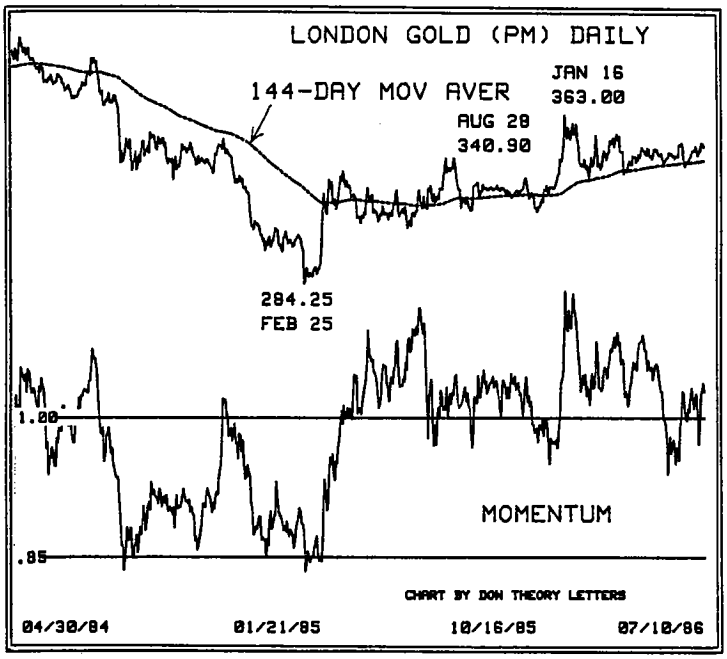
* *

A Ford-Cadillac? The new book, "Ford, the Men and the Machine" by Robert Lacey (Little, Brown & Co.), is both fascinating and instructive. Did you know that between 1900 and 1908 there were no less than 502 companies formed to manufacture autos? Today, those 502 are reduced to only four. By 1917 after many bankruptcies and mergers there were still 23 companies making cars in Detroit alone! Another amazing story: Back in 1902 Henry Ford had two partners in the Henry Ford Company. But Ford insisted on messing with racing cars instead of building the car the partners wanted. So the partners dumped Ford. They kept Henry's car but replaced his power unit with a precision single-cylinder engine. And they then changed the name of the company to the Cadillac Automobile Company. Cadillac was later bought out by GM. So the famous GM Cadillac car of today was orginally a Ford!

* *

Some of the big Texas millionaires (and billionaires) are in trouble. Former Governor John Connolly is having plenty of his own troubles and is looking to do some refinancing. On June 27 the WSJ reported that the whole Hunt empire is tottering. Clint Murchison (former owner of the Dallas Cowboys) has filed for bankruptcy. And today the state of Texas announced that it will run a $2.3 billion deficit. It really is sad, but we have to ask -- "What's happening?"

What's happening is that oil has deflated, and deflation in general is in the air. Very few Americans prepared for this unexpected event, least of all the heavily-leveraged Texans. As I've been saying for months, America is moving slowly but inevitably into the deflation and re-liquefication phase. As things slow down, as prices stand still or even come down, it becomes progressively harder to pay off the big debts. It's also progressively harder to raise prices and show inflation profits. The era of "real earnings" is entering -- and fast.



GOLD: The amazing thing about gold is that it doesn't encourage the bears by turning bearish, but it doesn't encourage the bulls either. In the last Letter I set the point & figure perimeters (by the way, the correct word is perimeter, NOT parameter) which are 360 on the upside (bullish breakout) and 332 on the downside (bearish breakout). So far, gold has avoided both points, but sooner or later we're going to get the verdict of the marketplace — 360 or 332.

The thing that is interesting to me is that gold is holding persistently ABOVE its moving average (see chart) despite the continuing collapse in commodity prices and despite the fact that world production of gold is rising. A slowly rising longer-term moving average is often the forerunner of an important bullish rise. Note also on my chart that gold momentum is still in the bullish zone.

Consider this interesting fact: Back in February 1985 the price of gold was 285 and the CRB Commodities Futures Index was 240. As of this week the price of gold is 348 (up 22%) and the CRB Index just broke below 200 (down 16%). What does it mean when commodities are in a bear market and gold is creeping higher? I can only guess, and I'm guessing that it means that individuals and probably central banks are accumulating the yellow metal. And they don't care whether prices of "things" are inflating or deflating. I'm guessing further that the accumulators want to diversify OUT OF PAPER, and if you are watching the growth of the money supply and the condition of the world debt and the world banking systems, who can blame the gold buyers?

While South African gold shares have been in the dog house, the gold people have been turning to the North American gold shares, and some of these have been doing well. On my list of interesting N. American shares are Galactic Resources (NASDAQ), Agnico Eagle (ASE), Echo Bay Mines (ASE). A package of these shares might work out over time, but don't expect instant action.

Another item (and I just bought some) of interest is the Nobel, a one-ounce pure platinum coin, minted at the Isle of Man. Nobels tend to sell at about 5% to 6% above the metal price, and last week's asking price for the coins was about $458. S. Africa is the main source of platinum, and should there be real trouble at the mines, the price of platinum can be expected to soar. Buyers of gold coins might consider holding say one Nobel for each three gold coins (diversification is important, even in precious metals).

LATE NOTES: As you read this, I'll be out of surgery and moving toward getting healthy again. My particular thanks to my wife, Faye, and my loyal employee, Lois Van Rhyn, who both donated blood for me (what more can you give but your own blood!).

"Dow Ends Its Second Worst Week Ever" screamed the LA Times on July 12., as the Dow dropped a fat 79.44 points for the week. However, I thought it was notable that odd-lot short selling averaged 74,000 shorts per day (!) during that week. Furthermore, my PTI closed the week at 2322, just six points under its all-time high (set July 2 at 2328).If this market is falling apart, my work doesn't show it — at least not yet.

On July 11 the DJ Utility Average closed at 204.05, an all-time record high, while on the same week 29% of the 112 utility stocks listed on the NYSE hit new highs. The new high utility list read like a who's who of utility shares recommended here.

The 114-day exponential moving average of the Dow now stands at 1730 (see page 1 chart). This level should offer strong support in case of further market weakness.

NEXT MAILING: July 30